UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF INDIANA
HAMMOND DIVISION AT HAMMOND

IN RE: CASE NO. 95-60046 RICHARD GARZA Debtor * J & J DISTRIBUTORS, INC. Plaintiff v. RICHARD GARZA Defendant	)	ADVERSARY PROCEEDING NO. 95-6037

FINDINGS OF FACT, CONCLUSIONS OF LAW, DECISION AND JUDGMENT

I

STATEMENT OF PROCEEDINGS

This Adversary Proceeding came before the Court for a bench trial.[1]

The Adversary Complaint filed by Plaintiff, J & J Distributors, Inc. ("J & J") is in two counts.

Count I of J & J's Complaint alleges that a certain indebtedness by the Defendant and Chapter 7 Debtor in Main Case No. 95-60046, Richard Garza ("Debtor"), to J & J in the

[1] There has been an inordinate delay between the submission of this Adversary Proceeding for trial and this Decision. At the Conclusion of the trial, the Court reserved its ruling and directed the parties to submit proposed findings of fact and conclusions of law within 30 days. Neither the Plaintiff nor the Defendant submitted proposed findings and conclusions as Ordered. In addition, the Debtor's Main Case No. 95-60046 was inadvertently closed, while this Adversary Proceeding was still pending. In light of the foregoing, the Court has proceeded to issue its Decision and Judgment, notwithstanding the fact that the parties had not submitted proposed findings an conclusions as directed by the Court.

principal sum of $201,753.00 is nondischargeable based on fraud pursuant to §523(a)(2), (A), on the basis that the Debtor made false statements to J & J in a certain Security Agreement executed by the Debtor on behalf of Shorty Corporation D/B/A A-OK Vending in favor of J & J to secure an indebtedness by Shorty Corporation to J & J.

Count II of J & J's Complaint alleges that the same debt by Shorty Corporation to J & J is nondischargeable by the Debtor pursuant to §523 (a) (6) based on the wilful and malicious conversion by the Debtor of certain music and amusement equipment, and the proceeds thereof, of Shorty Corporation which were subject to the Security Agreement granted by the Debtor on behalf of Shorty Corporation to J & J to secure a debt by the Shorty Corporation to J & J.

The Defendant filed his Answer and denied all of the material allegations of the J & J's Complaint.

II

FINDINGS OF FACT

That based on the testimony of the Debtor, the Court makes the following findings of fact

1. That the Debtor formed a corporation known as Shorty Corporation D/B/A A-OK Vending ("A-OK") In 1984 or 1985.

2. That the Debtor was originally a fifty per cent shareholder in A-OK; that sometime prior to May, 1990, probably in 1988 or 1989, he acquired 100 per cent ownership of the A-OK stock, and assumed all of the responsibilities of A-OK.

3. That the Debtor was the president of A-OK, and A-OK had no other officers.

4. That A-OK was in the vending business, i.e. it would place music and amusement equipment with various business establishments, whereby A-OK would share the proceeds received from operation of the equipment with the owner of the establishment on a 50-50 basis.

5. That A-OK ceased all operations sometime in December of 1991.

6. That the Debtor admitted that on May 22, 1990, the Debtor executed a Security Agreement in favor of J & J on behalf of A-OK (See Plaintiff's Exhibit "A").[2]

7. That said Security Agreement was granted by A-OK to J & J to secure a Note executed on May 22, 1990 by A-OK to J & J in the sum of $178,770.42, together with any liabilities then existing or thereafter arising by A-OK to J & J, which the Debtor admitted he executed on behalf of A-OK. (See Plaintiff's Exhibit "B").

8. That the Collateral granted to secure said Note pursuant to said Security Agreement was all equipment then owned or thereafter acquired by A-OK, including but not limited to "all those goods now particularly described on the attached Schedule A incorporated fully herein by reference", together with all additions, accessories and replacements, and "the proceeds thereof".

9. That the Schedule A attached to said Security Agreement, set out a detailed and itemized list of 95 separate pieces of various music and amusement equipment used by A-OK in its vending operation ("Equipment"); that this Schedule states "this is a true and accurate list", which the Debtor admitted he signed. (See Plaintiff's Exhibit "C").

10. That Paragraph I. E. of the Security Agreement provided that A-OK would not sell, assign, transfer, encumber, or otherwise dispose of the collateral or any interest therein without the prior written consent of J & J.

11. That Paragraph I. F. of the Security Agreement provided that A-OK would only use the Collateral for an amusement route, and that A-OK would not change the use thereof without J & J's written consent.

12. That the Debtor also admitted he executed two Indiana UCC-1 Financing Statements on behalf of A-OK as Debtor to J & J as the Secured party, which

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[2] The Debtor orally stipulated in open Court to the admission into evidence of all of the Plaintiff's Exhibits without formal proof.

were recorded with the Indiana Secretary of State and the Lake County, Indiana Recorder, to which were attached the same Schedule A which was attached to the Security agreement. (See Plaintiff's Group Exhibit "G").

13. That the Debtor asserted he could not recall if A-OK had all of the Equipment on Schedule A as of the date of the Note and Security Agreement were executed by him as he was "rotating a lot of machines", and "[I] was taking machines back to them, ... bringing them back, ..."

14. That the Debtor testified that the contents of the Security Agreement were not explained to him.

15. That the Debtor acknowledged he could read, and that he understood what the Security Agreement meant, i.e. that in response to the question by J & J's counsel "You understood that you would borrow money and in return they [J & J] were holding a security interest against the collateral you borrowed or the equipment borrowed", the Debtor answered "yes, I do".

16. That in response to a question by J & J's counsel, I. e. "You were not aware that you had to either give the proceeds to J & J Distributors or notify them of the sale", the Debtor answered "No, I was not aware of that."

17. That the Debtor could not recall how many payments were made by A-OK to J & J after the Note and Security Agreement were executed On May 22,1990, if any, and if any payments were made, when they were made, as all of the paperwork for A-OK was handled by the Debtor's ex-wife, but that based upon his examination of the the Bank Statements of Gainer Bank relating to A-OK's checking accounts with Gainer Bank no payments were made to J & J after the Note and Security Agreement were executed; however, as to checking account maintained by A-OK with Calumet National Bank, the Debtor acknowledged that upon an examination thereof one payment was made by A-OK to J & J by virtue of Check No. 1759 dated September 18, 1990 in the sum of $2,220.28. (See Plaintiff's Exhibits "P and Q).

18. That the Debtor acknowledged that he received copies of the Note and Security Agreement that he had executed on behalf of A-OK to J & J.

19. That the Debtor asserted he could not recall how many pieces of the Equipment given as Collateral to J & J, as set out on Schedule A to the Security Agreement, were in the possession of A-OK's customer-vendors or that he had in his actual possession at the time the Note and Security Agreement were executed on May 22, 1990, and he did not maintain any books and records as to who had possession of the Equipment.

20. That the Debtor usually checked with A-OK's vendor-customers bi-weekly, at which time a 50-50 division of the monies deposited in the Equipment was made at the time on the premises of the vendor-customers, and that the one-half kept by A-OK was deposited in its bank accounts; that the bi-weekly gross proceeds ranged from $50.00 to $150.00 or $200.00 for each piece of Equipment; and, that as a result A-OK netted approximately $4750.00 bi-weekly from the Equipment if all 95 pieces of Equipment had been placed with A-OK's vendor-customers at one time.

21. That the Debtor asserted he could not recall the names of any of A-OK's vendor-customers that had possession of the Equipment in the year 1990, or the number and identity of pieces or Equipment in the possession of A-OK's vendor-customers, nor could he recall how many pieces of the Equipment were in the possession of A-OK when the Security Agreement was executed on May 22, 1990, and that he did not maintain any books and records as to who had possession of the various pieces of Equipment as of May 22, 1990.

22. That the Debtor admitted that he sold "some" of the Equipment on Schedule A to the Security Agreement, but couldn't remember how many pieces were sold, or which specific Equipment itemized on Schedule "A" to the Security Agreement he had sold, and that he did not maintain any books and records as to what Equipment he sold, the sales price, or to who purchased the Equipment.

23. That on certain unspecified times the Debtor asked J & J if he could return the Equipment to J & J and J & J refused to accept same.

24. That the Debtor stated A-OK had no documentation showing that A-OK sold the Equipment, and could not recall if the proceeds of the various sales thereof were deposited in A-OK's checking accounts with Gainer Bank and Bank Calumet as his ex-wife handled all paperwork for A-OK.

25. That the Debtor acknowledged that as President of A-OK he had control over what his ex-wife did with respect to A-OK.

26. That A-OK had monthly expenses comprised primarily of rental of approximately $1000.00 a month, a monthly payment for a truck in the sum of approximately $340.00, plus monthly expenses for fuel, phone, and utilities, which were paid by the Debtor's ex-wife on behalf of A-OK by signing the Debtor's name to the checks of A-OK with his authorization.

27. That upon his examination of Schedule A to the Security Agreement that he could not identify any specific piece of Equipment that he had actually

returned to J & J.

28. That the Debtor stated that A-OK was losing money and after A-OK fell behind on its payments to J & J on the Note he requested that J & J take some unspecified Equipment back but J & J declined and offered to "renew the Contract".

29. That the Debtor received in a range of $200.00 to $1500.00 for the various unspecified pieces of Equipment that he admittedly sold; that he sold the same to "People in Chicago" but could not identify specifically who purchased the Equipment; that the purchasers took possession of the Equipment at A-OK's Warehouse; and, that all sales were in cash and no receipts were given.

30. That the proceeds from the sale of unspecified Equipment was used by the Debtor to pay ongoing business expenses of A-OK and to pay his personal expenses.

31. That A-OK would net approximately $4700.00 every two weeks if all 95 pieces of Equipment were placed with A-OK's vendors-customers at one time, but that at any given time not all 95 pieces of Equipment were in the possession of customer-vendors of A-OK.

32. That he kept no books or records whatsoever as to which pieces of Equipment were in the possession of the customer-vendor of A-OK and which pieces of Equipment were in the possession of the Debtor at any given time, or as to which pieces of Equipment were sold by the Debtor to unspecified third parties for cash.

33. That when the Debtor filed his Voluntary Chapter 7 Petition on June 10, 1995 he had none of the Equipment in his possession.

34. That A-OK incurred no fires or thefts regarding the Equipment and the Debtor admitted that he sold all of the Equipment not repossessed by J & J or returned to J & J by the Debtor; however, the Debtor could not identify any specific Equipment on Schedule A to the Security Agreement which was repossessed by J & J or returned by the Debtor to J & J.

That based on the testimony of Kevin L. Van Meter, the Court makes the following findings of facts:

1. That he was the Finance and Credit Manager of J & J.

2. That he was in charge, as Finance Manger, to oversee J & J's account with A-OK.

3. That the Note, Security Agreement and UC-C-1 Financing Statements executed by the Debtor on behalf of A-OK on May 22, 1990 were to refinance a previous debt in that J & J had originally sold the Equipment to the Debtor prior to May 22, 1990 and that J & J had assigned the original Note and Security Agreement to First American Bank ("Bank") who had financed the purchase.

4. That when A-OK defaulted on its debt to the Bank, the Bank recoursed the debt of A-OK to J & J, at which time the Note and Security Agreement dated May 22, 2000 were executed.

5. That when said Note and Security Agreement were executed by the Debtor on behalf of A-OK, Van Meter explained to the Debtor that the Equipment was collateral for the Note; that if payments were not made on the Note, J & J could repossess the Equipment; that if A-OK decided to sell the Equipment the Debtor would have to first notify J & J; and, that the purpose of Equipment was to maintain an amusement route and not for resale.

6. That at the time the Debtor signed the Note, Security Agreement, and UCC-1 Financing Statements, the Debtor stated he had all 95 pieces of Equipment listed on Schedule A to the Security Agreement in his possession.

7. That the list of 95 pieces of Equipment as set out in Schedule A to the Security Agreement was complied through J & J's computer program which tracked all Equipment sold by J & J and all Equipment returned to J & J, including trade-ins.

8. That through J & J's computerized records, pursuant to said computer program, J & J could ascertain that Schedule A was a list of all Equipment that the Debtor had in his possession as of May 22, 1990.

9. That the Debtor never informed J & J that he had sold any of the Equipment.

10. That by virtue of a letter by Van Meter on behalf of J & J to the Debtor dated June 26, 1990, J & J enclosed a copy of the Note and Security Agreement executed by the Debtor on behalf of A-OK on May 22, 1990, and informed the Debtor that A-OK had made the initial payment on the Note, but was in default as to its second payment on the Note, which was to be paid by June 29, 1990. (See Plaintiff's Exhibit "R").

11. That after the Note and Security Agreement was executed A-OK made only one payment.

12. That thereafter J & J instituted a replevin action in the State Court to repossess the Equipment at some unspecified time in 1990.

13. That J & J thereafter repossessed 18 pieces of the Equipment. (See Plaintiff's Exhibit "V") (Portions highlighted in yellow).

14. That J & J complied a list of seventy-seven separate pieces of Equipment that was never repossessed by J & J or returned by the Debtor to J & J (See Plaintiff's Exhibit "M").

15. That J & J had an established business practice and procedure, whereby in the ordinary course of its business, if a piece of equipment is returned to it, or repossessed by it, its dock workers unloaded the equipment, and a receiving ticket was made out at that point which showed the customer's name, the piece of equipment and its serial number; and, at that point a credit invoice is mailed to the customer.

16. That two employees of J & J visited a number of the locations where various pieces of the Equipment had allegedly been placed with various customer-vendors of A-OK by the Debtor, and they reported to J & J that the Debtor, or his employees, had either removed the same, that the Equipment had been sold to third parties, they had never heard of the Debtor, or they never had any of the Equipment at their location.

Based on the testimony of Patrick J. Harper, the Court makes the following findings of fact:

1. That he is the Vice-President, General Manager, and part owner of J & J holding those positions since 1982; that from 1969 to 1982 he was a sales person for J & J calling on music and game operators in Indiana and Kentucky.

2. That he was present when the Debtor executed the Note and Security Agreement to J & J on behalf of A-OK, and that Van Meter explained these documents to the Debtor.

3. That since 1969 he has had extensive experience in ascertaining the value of music and amusement equipment; that the normal rule of thumb in the industry is that this type of Equipment depreciates on an average at the rate of twenty percent per year based on normal wear and tear.

4. That he and Van Meter complied a detailed list of the seventy-seven pieces of Equipment that were never repossessed by J & J or returned by the Debtor to J & J by model and serial number, and in late 1990 or early 1991 assigned an estimated wholesale value thereto of $159,830.00 based on their extensive experience in the industry and by reference to various trade publications of $159,830.00; that this amount was based on the fact that the Equipment was purchased new in 1990, was approximately one year old when it was not returned to J & J, and based on the normal rule of thumb in the industry that the Equipment in question depreciates about twenty per cent per year, he deducted twenty per cent from the original purchase price of each piece of Equipment; that no actual physical inspection of the Equipment was made as the missing pieces of Equipment were not made available by the Debtor for inspection by J & J. (See Plaintiff's Exhibit "M").

III

Conclusions of Law and Discussion

A.

Jurisdiction

The Court concludes that it has subject-matter jurisdiction over this Adversary Proceeding pursuant to 28 U.S.C. §1334(b), and that this Adversary proceeding is Core Proceeding pursuant to 28 U.S.C. §157(b)(2)(I).

This Court would also note that is has the authority to determine both the dischargeablity of any indebtedness of the Defendant to the Plaintiff (liability), and damages. In re Hallahan, 936 F.2d 1496, 1507-08 (7th Cir. 1991).

B.

Burden of Proof and Standard of Proof

In keeping with the purpose of the Bankruptcy Code, exceptions to the general rule of dischargeability of debts are to be strictly construed against the creditor and liberally in favor of the Debtor. Meyer v. Rigdon, 36 F.3d 1375, 1385 (7th Cir. 1994); Matter of

Scarlata, 979 F.2d 521, 524 (7thCir. 1992) (citing, In re Zarzynski, 771 F.2d 304, 306 7th Cir. 1985); In re Linn, 38 B.R. 762, 763 (9th Cir. B.A.P. 1984); In re Marino, 29 B.R. 797, 799 (N. D. Ind. 1983)). This is done to effectuate the fresh start policies of the Bankruptcy Code. Meyer v. Rigdon, 36 F.3d at 1385, supra; In re Kimzey, 761 F.2d 421, 424 (7th Cir. 1985); In re Levitan, 46 B.R. 380, 383 (Bankr. E. D. N. Y. 1985); In re Nicoll, 42 B.R. 87, 90 (Bankr. N. D. Ill. 1984).

In an Adversary Proceeding to determine the nondischargeability of a debt the burden of proof is on the plaintiff as to each element. Matter of Scarlata, 979 F.2d at 524, supra; In re Kreps, 700 F.2d 372, 376 (7th Cir. 1983). Compare In re Martin, 698 F.2d 881, 887 (7th Cir. 1983), (general §727 discharge case).

The United States Supreme Court in the case of Grogan v. Garner, 498 U. S. 279, 111 S. Ct. 654, 112 L. Ed.2d 755 (1991), held that the standard of proof in nondischargeablity proceedings under §523(a) is by a preponderance of evidence standard, rather than the more stringent standard of clear and convincing evidence. Id., 111 S. Ct. at 661.

C.

Count I of J & J's
Complaint Based on
§523(a)(2)(A)

Count I of J & J's Complaint alleges that the debt by A-OK to J & J is nondischargeable by the Debtor pursuant to §523(a)2)(A), in that he made fraudulent representations to J & J at the time he executed the Note and Security Agreement on behalf of A-OK on May 22, 1990, that A-OK would not sell or otherwise dispose of the Equipment

without the prior written consent of J & J, and that the Equipment would only be used for amusement route as provided by Paragraphs I.E. and I.F. of the Security Agreement.

Section 523(a)(2)(A) of Title 11 provides as follows:

> §523. Exceptions to discharge.
>
> (a) A discharge under section 727, 1141, or 1328(b) of this title does not discharge an individual debtor from any debt–…
>
> * * * *
>
> (2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by--
>
> > (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition;…

In order to prevail under §523(a)(2)(A), the creditor must prove more than fraud implied in law. As noted in the legislative statements to §523(a)(2)(A):

> Subparagraph (A) is intended to codify current case law, e.g., Neal v. Clark, 95 U.S. [5 Otto] 704 [24 L. Ed. 586] (1887), which interprets "fraud" to mean actual or positive fraud rather than fraud implied in law.

124 Cong. Rec. H11095-96 (Daily Ed. Sept. 28, 1978); S17412 (Daily Ed. Oct. 6, 1978).

It is now well established that the issue of the nondischargeability of a debt pursuant to §523(a) is a matter of federal law governed by the terms of the Bankruptcy Code. Grogan v. Garner, 498 U.S. 279, 111 S.Ct. 654, 657, 112 L. Ed. 2d 755 (1991); Brown v. Felsen, 442 U.S. 127, 129-30, 136, 99 S.Ct. 2205, 2208-09, 2211, 60 L. Ed. 2d 767 (1979); Matter of Sheridan, 104 F.3d 1164, 1167 (7th Cir. 1997); Mayer v. Spanel Intern'l. Ltd., 51 F.3d 670, 675 (7th Cir. 1995).

While the issue of the nondischargeability of a debt as governed by federal law, the Supreme Court in Field v. Mans, -U.S.-, 116 S.Ct. 437,133 L. Ed.2d 351 (1995), construed §523(a)(2)(A) to incorporate the general common law of torts under the dominate consensus of the common law jurisdictions, rather than the law of any particular state. Id. 116 S.Ct. at 443 + n.9.

It has been held by the United States Court of Appeals, Seventh Circuit, that the essential elements to be proved by the Plaintiff-Creditor pursuant to §523(a)(2)(A) are as follows:

1. **That the debtor obtained the money (property of services) through representations which the debtor either knew to be false or made with such reckless disregard for the truth as constitutes a willful misrepresentation;**

2. **That the debtor possessed scienter, i.e. an intent to deceive; and**

3. **That the creditor actually relied on the false representation and the reliance was reasonable.[3]**

In re Kimzey, 761 F.2d 421, 423 (7th Cir. 1983); Matter of Scarlata, 979 F.2d 521, 525 (7th Cir. 1992). See also In re Faulk, 69 B.R. 743, 749-50 (Bankr. N. D. Ind. 1986); In re Guy, 101 B.R. 961, 978-79 (Bankr. N. D. Ind. 1988); In re Fitzgerald, 109 B.R. 893, 897-98 (Bankr. N. D. Ind. 1989). Compare In re Howard, 73 B.R. 694, 700-08 (Bankr. N. D. Ind. 1987) (§523(a)(2)(B) as to false financial statement).

The creditor also has the burden of establishing the debtor's fraudulent intent at the

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[3] **In Field v. Mans, ____ U.S. ____, ____ + n. 9, 116 S.Ct. 437, 443 + n. 9, 133 L. Ed.2d 351 (1995), the United States Supreme Court held that §523(a)(2)(A), requires a showing of justifiable reliance, rather than reasonable reliance in order to except a debt from discharge.**

inception of the debt. In re Guest, 193 B.R. 745, 749 (Bankr. E. D. Pa. 1996) (citing, Matter of Gross, 175 B.R. 277, 285 (Bankr. N. D. Ind. 1994)); In re Woodall, 177 B.R. 517, 523-524 (Bankr. M. D. Md. 1995); In re Guy, 101 B.R. 961, 979 (Bankr. N. D. Ind. 1988); Matter of Fontana, 92 B.R. 559, 561 (Bankr. M. D/ Ga. 1988); In re laquinta, 95 B.R. 576, 578 (Bankr. N. D. Ill. 1989); In re Todd, 34 B.R. 633, 635 (Bankr. W. D. Ky 1983); In re Kelsey, 9 B.R. 154, 157 (Bankr. W. D. Ky 1981)); In re Hunt, 30 B.R. 425, 447 (M. D. Tenn 1983) (Where a check is delivered in payment for goods and services that have already been suppled, reliance on the check is absent). That is, the allegedly fraudulent conduct by the debtor, must be the proximate cause of the damages caused to the creditor, and must have existed at the time of, and been the methodology by which the money, property, or services were obtained. In re Woodall, 177 B.R. at 523. (collecting cases).

This Court must determine whether the Defendant merely breached a contract with the Plaintiff, or whether the Defendant committed actual or positive fraud, as, of course, a mere breach of contract, i.e., the failure by the Defendant to perform in the future as agreed, without more, is a dischargeable debt sounding in contract rather than fraud. As this Court stated in In re Schmidt, 70 B.R. 643 (Bankr. N. D. Ind. 1986):

> There must be proof of positive fraud and this involves showing that the acts which constitute fraud involved moral turpitude or an intentional wrong; and fraud implied in law which does not require a showing of bad faith or immorality is insufficient. In re Gilman, 31 B.R. 927, 929 (Bankr. S. D. Fla. 1983); In re Montbleau, 13 B.R. 47, 48 (Bankr. D. Mass. 1981); In re Byrd, 9 B.R. 357, 359 (Bankr. D. C. 1981); In re McAdams, 11 B.R. 153, 155 (Bankr. D. Vt. 1980); In re Slutzky, 22 B.R. 270, 271 (Bankr. E. D. Mich S. D. 1982). Therefore, a mere breach of contract by the debtor without more, does not imply existence of actual fraud for purposes of the exception to

> discharge under Section (a)(2)(A). In re Emery, 52 B.R. 68, 70 (Bankr. E. D. Pa. 1985). However, if a debtor enters into a contract intending not to comply with its terms and later defaults under that contract, such contract may provide a basis for exceptions to discharge on the grounds of fraud if the other remaining elements are satisfied. In re Taylor, 49 B.R. 849, 851 (Bankr. E. D. Pa. 1985); In re Fenniger, 49 B.R. 307,310 (Bankr. E. D. Pa. 1985).
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> It has also been correctly held that, by itself, a mere failure to fulfill a promise to pay for goods on credit is not fraudulent, so as to render a debt nondischargeable. In re Salett, 53 B.R. 925, 928 (Bankr. D. Mass. 1985). However, when a debtor purchases goods on credit knowing he does not intend to pay for the goods or knowing he is unable to comply with the requirements of the contract, the debtor may be nondischargeable. Id., at 928.

Id., 70 B.R. at 639-40. See also In re Bercier, 934 F.2d 689, 692 (5th Cir. 1991) (false representation must concern present or past asserted facts. Representations or promises to do future actions do not qualify unless debtor never intended to perform); In re Rubin, 875 F.2d 755, 759 (9th Cir. 1989). "[O]pinions as to future events which the declarant does not, in fact, hold or declarations made with reckless indifference to the truth may be found to be fraudulent". A promise made with a positive intent not to perform or without a present intent to perform satisfies §523(a)(2)(A)). (quoting In re Fordyce, 56 B.R. 102, 105 (Bankr. M. D. Fla. 1985); In re Krause, 114 B.R. 582, 606 (Bankr. N. D. Ind. 1988). However, if the debtor has made a statement of future intention, it may be possible that the statement was true when made, and intervening events may have caused his future actions to deviate from his prior intentions. Matter of Scarlata, 979 F.2d at 525 (citing, W. Page Keaton, et. al., Prosser and Keaton on the Law of Torts, §109 at 764-65 (5th Ed. 1984)).

In In re Guy, 101 B.R. 961, this Court stated:

> [a] mere breach of contract by the debtor without more, does not imply existence of actual fraud for purposes of the exception to discharge under §523(a)(2)(A). In re Emery, 52 B.R. 68, 70 (Bankr. E. D. Pa 1985).

> **Accordingly, a mere promise to be executed in the future is not sufficient to make a debt non-dischargeable, even though there is no excuse for the subsequent breach. In re Barker, 14 B.R. 852, 567 (sic) (Bankr. E. D. Tenn. 1981). See also 3 Collier on Bankruptcy, para. 523.08, p. 523-47 (I. King 15th ed.). That is, subsequent conduct contrary to a former representation does not necessarily render the original representation to be false. In re Boese, 8 B.R. 660, 662 (Bankr. D. N. Dak. 1981). However, if a debtor enters into a contract intending not to comply with its terms and later defaults under that contract, such contract may provide a basis for exceptions to discharge on the grounds of fraud if the other remaining elements are satisfied, In re Taylor, 49 B.R. 849, 851 (Bankr. E. D. Pa. 1985); In re Fenniger, 49 B.R. 307, 310 (Bankr. E. D. Pa. 1985).**
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> **The Court may logically infer an intent not to pay frm the relevant facts surrounding each particular case. See In re Kimzey, 761 F.2d 421, 424, supra. And a person's intent, his state of mind, has been long recognized as capable of ascertainment and a statement of present intention is deemed a statement of a material existing fact sufficient to support a fraud action. In re Pannell, 27 B.R. 298, 302 (Bankr. E. D. N. Y. 1983). While as a general proposition the alleged fraud must exist at the inception of the debt, and statements or actions which were neither false nor fraudulent when made will not be made so by the happening of subsequent events, a promisor's subsequent conduct may reflect his state of mind at the time he made the promise and thus be considered in determining whether he possessed the requisite fraudulent intent. In re Kelsey, 9 B.R. 154, 157 (Bankr. W. D. Ky. 1981). Nevertheless, false representations or false statements encompass statements that falsely purport to depict current or past facts and do not relate to future action. In re Todd, 34 B.R. 633, 635 (Bankr. W. D. Ky. 1983).**

Id., 101 B.R. 978-79 (Emphasis in original). See also Palmacci v. Umpierrez, 121 F.3d 781, 786-87 (1st Cir. 1997); In re Faulk, 69 B.R. 743, 750 (Bankr. N. D. Ind. 1986); In re Barr, 194 B.R. 1009, 1017-1018 (Bankr. N. D. Ill. 1996) citing, In re Guy with approval); In re Zachary, 147 B.R. 881, 883-884 (Bankr. N. D. Tex. 1992, (quoting, In re Guy with approval). As this Court observed in In re Faulk, 69 B.R. 743:

> **This finding of fact as to [fraudulent] intention will obviously have to be determined by circumstantial evidence in most cases as direct evidence the**

> Defendant's state of mind at the time of purchase is seldom expressly indicated. Although this is certainly a difficult task, it is not greater a task than any other cause of action that includes intent or state of mind as a necessary element. And the existence of fraud may be inferred if the totality of the circumstances present a picture of deceptive conduct by the Debtor which indicates he intended to deceive or cheat the creditor. In re Fenniger, 49 B.R. 307, 310, supra; In re Kimzey, 761 F.2d 421, 424, Supra. And a persons intent, his state of mind, has been long recognized as capable of ascertainment and a statement of present intention is deemed a statement of a material existing fact sufficient to support a fraud action. In re Pannell, 27 B.R. 298, 302 (Bankr. E. D. N. Y. 1983).

Id. 69 B.R. at 755.

J & J submitted no competent circumstantial evidence showing by a preponderance of the evidence that, based upon the surrounding circumstances, the Debtor fraudulently represented that all ninety-five pieces of Equipment were either in his possession or in the possession of A-OK's customer-vendors when, in fact, they were not, or that he fraudulently intended not to perform as agreed under the terms and conditions of the Security Agreement at the time it was executed by him on May 22, 1990. The evidence only showed that the Debtor subsequently breached the Security Agreement by the unauthorized sale of the Equipment. Evidence of a mere breach of contract, i.e. a failure to perform in the future will not support a nondischargeability judgment pursuant to §523(a)(2)(A). Thus, J & J cannot prevail pursuant to Count I of its Complaint based upon fraud pursuant to §523(a)(2)(A).

Even assuming arguenndo that a fraudulent intent by the Debtor was present when he executed the Security Agreement not to perform as agreed, the Debtor, as sole officer and stockholder of A-OK, was already in possession of the Equipment when the Security Agreement was executed, as he had purchased and taken possession of the Equipment pursuant to a Sale Agreement entered into between J & J and A-OK approximately one year

before the Security Agreement was executed. Thus, even though the Debtor's conduct might be found to be fraudulent, this alleged fraud did not cause J & J to depart with the Equipment, as the Equipment was already in the Debtor's possession. As noted above, to prevail on the basis of actual fraud pursuant to §523(a)(2)(A), the fraudulent acts of the Debtor must have caused the creditor to depart with the money, property, or services that were obtained by the Debtor from the creditor. See In re Woodall, 177 B.R. at 523 Supra (Collecting cases). Since J & J advanced no monies or sold no additional Equipment to A-OK when the Security Agreement was signed, any alleged fraud by the Debtor at the time of the execution thereof was not the proximate cause of any damages to J & J. Thus, judgment for the Debtor shall be entered as to Count I only.

D

Count II of J & J's Complaint
Based on §523(a)(6)

Count II of J & J's Complaint alleges that the Debtor wilfully and maliciously converted the Equipment of A-OK and the proceeds thereof, given as collateral to J & J to secure the Note executed by the Debtor on behalf of A-OK by virtue of the Security Agreement executed by the Debtor on behalf of A-OK, and accordingly the debt by A-OK to J & J arising from said conversion is nondischargeable by the Debtor pursuant to §523(a)(6). Section 523(a)(6) of title 11 states as follows:

> (a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt--
>
> * * * *

(6) for willful and malicious injury by the debtor to another entity or to the property of another entity;...

The Congressional Record Statements to §523(a)(6) state that the phrase "willful and malicious injury covers a willful and malicious conversion". 124 Cong. Rec. H11096 (daily ed. Sept. 28, 1978); S17412 (daily ed. October 6, 1978): Remarks of Rep. Edwards and Sen. DeConcini. This Court in the case of In re Mills, 111 B.R. 186 (Bankr. N.D. Ind. 1988), had occasion to discuss at some length the dischargeability of a debt under §523(a)(6) based on an alleged conversion of property of another. The Court will summarize the salient points in the Mills case as follows:

1. **The Plaintiff has the burden of proof to show in the conjunctive that the acts or conduct of the Debtor complained of were both "willful and malicious". Mills, 111 B.R. at 194.**

2. **"Willful" in §523(a)(6) means a deliberate or intentional act. Mills, 111 B.R. at 192.**

3. **Mere negligence, or reckless disregard, is not sufficient to establish "willful and malicious" conduct under §523(a)(6) by federal standards. The act must be deliberate and intentional. Mills, 111 B.R. at 192.**

4. **For an act to be "willful and malicious", the debtor must act in an intentional or deliberate manner without just cause or excuse, which produces or results in harm or injury, but the debtor need not have a specific intent to cause the resulting harm or injury to the person or property of the plaintiff. It is the intent to do the act which is the operative legal event, and not the intent to do the harm. Mills, 111 B.R. at 194.**

5. **As to the "malicious" element, the plaintiff need not show actual and personal hatred, ill will, spite, or special malice by the debtor toward him. Constructive or implied malice is sufficient, and a specific intent to do harm to the plaintiff is not necessary. Mills, 111 B.R. at 194.**

6. **Although the Debtor may be liable for a technical, innocent, or mistaken**

> conversion under state common law, even if there is no "mens rea", §523(a)(6) requires willfulness and malice as defined by federal standards. Mills, 111 B.R. at 192.

In the subsequent case of In re Matter of Marvin C. Thirtyacre, 36 F.3d 697 (7th Cir. 1994), the United States Court of Appeals, Seventh Circuit, concluded that "Under §523(a)(6) of the Bankruptcy code, willful means deliberate or intentional... [and] [m]alicious means in conscious disregard of one's duties or without just cause or excuse; it does not require ill-will or specific intent to do harm." Id., 36 F.3d at 700, (quoting, Wheeler v. Laudani, 783 F.2d 610, 615 (6th Cir. 1986)).

The Supreme Court in the case of Kawaauhau v. Geiger, 523 U.S. 57, 118 S. Ct. 974, 140 L. Ed. 2d 90 (1998), expressly held that debts arising from recklessly or negligently inflicted injuries do not fall within the compass of wilful and malicious exception to discharge pursuant to §523(a)(6). The Court observed:

> The word "willful" in (a)(6) modifies the word "injury," indicating that nondischargeability takes a deliberate or intentional injury, not merely a deliberate or intentional act that leads to injury. Had Congress meant to exempt debts resulting from unintentionally inflicted injuries, it might have described instead "willful acts that cause injury". Or, Congress might have selected an additional word or words, i.e., "reckless" or "negligent," to modify "injury." Moreover, as the Eighth Circuit observed, the (a)(6) formulation triggers in the lawyers' mind the category "intentional torts," as distinguished from negligent or reckless torts. Intentional torts generally require that the actor intend "the consequences of an act," not simply "the act itself." Restatement (Second) of Torts §8A, comment, a. p. 15 (1964) (emphasis added).
>
> The Kawaauhaus' more encompassing interpretation could place within the excepted category a wide range of situations in which an act is intentional, but injury is unintended, i.e., neither desired nor in fact anticipated by the debtor. Every traffic accident stemming from an initial intentional act -- for example, intentionally rotating the wheel of an automobile to make a left-hand turn without first checking oncoming traffic - could fit the description. See 113

F.3d at 852. A "knowing breach of contract" could also qualify. See ibid. A construction so broad would be incompatible with the "well-known" guide that exceptions to discharge "should be confined to those plainly expressed." Gleason v. Thaw, 236 U.S. 558, 562, 35 S. Ct. 287, 289, 59 L. Ed. 717 (1915).

* * * *

That decision, [Tinker v. Colwell, 24 S. Ct. 505 (1904)], we clarify, provides no warrant for departure from the current statutory instruction that to be nondischargeable, the judgment debt must be "for willful and malicious injury."

Subsequent decisions of this Court are in accord with our construction. In McIntyre v. Kavanaugh, 242 U.S. 138, 37 S. Ct. 38, 61 L. Ed. 205 (1916), a broker "deprive[d] another of his property forever by deliberately disposing of it without semblance of authority." Id., at 141, 37 S. Ct. at 39. The Court held that this act constituted an intentional injury to property of another, bringing it within the discharge exception. But in Davis v. Aetna Acceptance Co., 293 U.S. 328, 55 S. Ct. 151, 79 L. Ed. 393 (1934), the Court explained that not every tort judgment for conversion is exempt from discharge. Negligent or reckless acts, the Court held, do not suffice to establish that a resulting injury is "willful and malicious." See id., at 332, 55 S. ct. at 153.

* * * *

We hold that debts arising from recklessly or negligently inflicted injuries do not fall within the compass of §523(a)(6).

Id., 118 S. Ct. at 977-98 (Emphasis in original).

It is clear that a debt for wilful and malicious conversion of property of another entity is nondischargeable under §523(a)(6). In re Kimzey, 761 F.2d, 421, 424 (7th Cir. 1985), (citing, In re Meyer, 7 B.R. 932, 933 (Bankr. N.D. Ill. 1981)).[4] A debt may be

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[4] Numerous cases have held that the failure of the debtor to deliberately and intentionally account for collateral, or the proceeds thereof, have rendered such a conversion nondischargeable to a secured creditor pursuant to §523(a)(6). See e.g., Ford Motor Credit Co. v. Owens (In re Owens), 807 F.2d 1556, 1559 (11th Cir. 1987) (Debtor, majority stockholder and president of car dealership, disposed of cars which were collateral for

nondischargeable under §523(a)(6) when the debtor has sold collateral subject to a security agreement thereby depriving the creditor of its secured interest. Id. 761 F.2d at 425. When the debtor sells secured collateral, the creditors' security interest - its protection against the debtor's bankruptcy vanishes. Id. Finding the debt nondischargeable under §523(a)(6) thus puts the creditor in the same position he would have been in but for the wilful and malicious conversion. Id. See also, Matter of Scarlata, 979 F.2d at 527 + N. 8 (Section 523(a)(6) cases typically fall into one of two categories: (1) Claims by a creditor that a debtor sold collateral subject to a security agreement, and, (2) attempts by creditors to have previously entered judgments against the debtor found nondischargeable); Davis v. Aetna Acceptance Co., 293 U.S. 328, 55 S. Ct. 151, 79 L. Ed. 939 (1935) (Interpreting §17(2) of the

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business loan without accounting for the proceeds in violation of floor plan arrangement); Chrysler Credit Corp. v. Perry Chrysler Plymouth, Inc. (In re Perry), 783 F.2d 480, 486 (5th Cir. 1986) (Individual Debtor's taking of sales proceeds belonging to business lender for personal use amounted to a nondischargeable conversion); Bancfirst v. Padgett (In re Padgett), 105 B.R. 665, 667 (Bankr. E.D. Okla. 1989) (Debtor, majority stockholder and president of car dealership intentionally failed to remit proceeds from sale of inventory to creditor); Mercury Marine Acceptance Corp. v. Wheeler (Matter of Wheeler), 96 B.R. 201, 205 (W.D. Mo. 1988) (Debtor as president of corporation in the business selling boats, did not have corporation forward proceeds of sale of boat to financier as required by contract); Standard Bank & Trust Co. v. Iaquinta (In re Iaquinta), 95 B.R. 576, 581-82 (Bankr. N.D. Ill. 1989) (Debtor, shareholder and officer of car dealership, intentionally used proceeds of collateral for personal use); Champion Home Builders Co. v. Tarrant (In re Tarrant), 84 B.R. 831, 833 (Bankr. N.D. Fla. 1988) (Debtor, officer of corporation in business of selling mobile homes, intentionally failed to remit proceeds from sale of mobile homes to creditor); In re Beasley, 62 B.R. 653, 655 (Bankr. W.D. Mo. 1986) (Debtors' use of proceeds from the sale of grain which was collateral for loan amounted to embezzlement and conversion); State National Bank v. Cullen (In re Cullen), 71 B.R. 274, 282 (Bankr.W.D. Wis. 1987) (Debtor as vice president of farming corporation was liable for conversion of proceeds from the sale of cattle which were security for loan); Dominion National Bank v. Gantt (In re Gantt), 56 B.R. 852, 856-58 (Bankr. W.D. Va. 1985) (Debtor as proprietor of a convenience store was liable for conversion of equipment and inventory which were security for note when he sold the business without turning over the proceeds of the sale to the secured creditor); Waukesha State Bank v. Sindic (In re Sindic), 44 B.R. 167, 172 (Bankr. E.D. Wis. 1984) (Debtor, while in the business of rebuilding damaged cars, sold automobiles which were security for loans without remitting proceeds to creditor); Ford Motor Credit Co. v. Emporelli (In re Emporelli), 42 B.R. 814, 820 (Bankr. W.D. Pa. 1984) (Debtor as shareholder and president of car dealership intentionally failed to remit proceeds of collateral which were to be used to pay secured creditor); First National Bank v. Grace (Matter of Grace), 22 B.R. 653, 657 (Bankr. E.D. Wis. 1982) (Debtor, who had assigned his portion of a note receivable as collateral for a loan, subsequently used the proceeds of the receivable for other purposes); Bombardier Corp. v. Penning (In re Penning), 22 B.R. 616, 619 (Bankr. E.D. Mich. 1982) (Debtor, as officer of corporation in the business of selling snowmobiles, failed to remit proceeds from the sale of collateral to the creditor).

former Bankruptcy Act, Former 11 U.S.C. §35). Collier on Bankruptcy, ¶523.12[2], pp. 523-91-94 (L. King 15th rev.). However, as noted by Judge Cardoza in Davis v. Aetna Acceptance Co., 293 U.S. 328, supra:

> There is no doubt that an act of conversion, if wilful and malicious, is an injury to property within the scope of this exception. Such a case was McIntyre v. Kavanaugh, 242 U.S. 138, where the wrong was unexcused and wanton. But a wilful and malicious injury does not follow as of course from every act of conversion, without reference to the circumstances. There may be a conversion which is innocent or technical, an unauthorized assumption of dominion without wilfulness or malice. Boyce v. Brockway, 31 N.Y. 490, 493; Laverty v. Snethen, 68 N.Y. 522, 527; Wood v. Fisk, 215 N.Y. 233, 239; 109 N.E. 177; Stanley v. Gaylord, 1 Cush (Mass.) 536, 550; Compau v. Bemis, 35 Ill. App. 37; In re DeLauro, 1 F. Supp. 678, 679. There may be an honest, but mistaken belief, engendered by a course of dealing, that powers have been enlarged or incapacities removed. In these and like cases, what is done is a tort, but not a wilful and malicious one.
>
> Id., 293 U.S. at 332.

As this Court noted in In re Mills, 111 B.R. at 186, supra, although this Adversary Proceeding pursuant to §523(a)(6) is based on conversion and sounds in tort, it is often based upon an underlying written Security Agreement entered into between the parties pursuant to state law. Id., 111 B.R. at 196. Thus, although the dischargeability of a debt under §523(a)(6) is determined by federal law, the Court will first look to state law or the law of Indiana, and the terms and conditions of the Security Agreement to determine the rights and duties of the respective parties.[5] The Security Agreement executed by the Debtor

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[5] The Bankruptcy Code defines a "security interest" as a "lien" created by agreement. 11 U.S.C. §101(51). Whether an agreement creates a lien depends on state law. In re Matter of Martin Grinding & Machine Works, Inc., 793 F.2d 592, 594 (7th Cir. 1986) (citing, Butner v. United States, 440 U.S. 48, 54-57, 99 S. Ct. 914, 917-19, 59 L. Ed. 2d 136 1979)). State law is also determinative of whether an interest in property has been properly perfected prior to the filing of a bankruptcy proceeding such that a trustee or debtor-in-possession

on behalf of A-OK in favor of J & J on May 22, 1990, states, in part, as follows:

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cannot avoid the perfected interest. In re Casbeer, 793 F.2d 1425, 1440 (5th Cir. 1986) (citing, Butner, supra); In re Gulino, 779 F.2d 546, 550 (9th Cir. 1985)).

> Indiana Code 26-1-9.1-203 sets out the general rules as to the attachment and enforcement of a security interest in collateral and the proceeds thereof. This section provides, in relevant part, as follows:
>
> > (a) A security interest attaches to collateral when it becomes enforceable against the debtor with respect to the collateral, unless an agreement expressly postpones the time of attachment.
> >
> > (b) Except as otherwise provided in subsections (c) through (I), a security interest is enforceable against the debtor and third parties with respect to the collateral only if:
> >
> > > (1) value has been given;
> > >
> > > (2) the debtor has rights in the collateral or the power to transfer rights in the collateral to a secured party; and
> > >
> > > (3) one (1) of the following conditions is met:
> > >
> > > (A) The debtor has authenticated a security agreement that provides a description of the collateral and, if the security interest covers timber to be cut, a description of the land concerned.
> >
> > * * * *
> >
> > (f) The attachment of a security interest in collateral gives the secured party the rights to proceeds provided by IC 26-1-9-315 and is also attachment of a security interest in a supporting obligation for the collateral.
>
> In addition, I.C. 26-1-1-103 provides follows:
>
> Unless displaced by the particular provisions of I.C. 26-1, the principles of law and equity, including the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, or other validating or invalidating cause shall supplement the provisions of I.C. 26-1.

The law of contracts supplements I.C. 26-1-1-103. Continental Grain Co. v. Followell, 475 N.E. 2d 318, 321 (Ind. App. 1985). For example, the terms and conditions in a security agreement can be wiaved. See Annon, Inc. v. Farmers Production Credit, 446 N.E. 2d 656, 659-61 (Ind. App. 1983). Compare, Hall v. Owen County State Bank, 370 N.E.2d 918, 924 + n. 2 (Ind. App. 1977) (general provisions of I.C. 26-1-1-103 were supplanted by specific language of I.C. 26-1-9-501(3) prohibiting a secured party from incorporating a waiver provision in a security agreement).

The Undersigned ("Debtor") grants to J & J Distributors, Inc., Indianapolis, In. 46229, ("Secured Party") a security interest in the following described property, together with all additions, accessions, accessories and replacements:

> **ALL MUSIC AND AMUSEMENT EQUIPMENT NOW OWNED AND HEREAFTER ACQUIRED INCLUDING BUT NOT LIMITED TO ALL THOSE GOODS NOW PARTICULARLY DESCRIBED ON THE ATTACHED SCHEDULE A INCORPORATED FULLY HEREIN BY THIS REFERENCE.**

(all called the "Collateral"), and in the proceeds thereof to secure the payment of a debt in the total principal amount of $178,716.42...

*** * * ***

1. Debtor's Representations and Warranties. Debtor represents, warrants and covenants that:

*** * * ***

E. Transfer of Collateral, Other than the sale of inventory in the ordinary course of business, Debtor shall not sell, assign, transfer, encumber or otherwise dispose of the Collateral or any interest therein without (a) giving Secured Party ten (10) days prior written notice or (b) without the prior written consent of Secured Party [strike either (a) or (b)]. If any encumbrance is imposed under the Collateral by operation of law, Debtor shall give Secured Party immediate written notice of this fact.

F. Use of Collateral. The Collateral shall be used only for the following purposes: Amusement Route.

The Debtor acknowledges that he signed the Security Agreement although he did not read the same before signing the same. It is a general rule of contract formation that a court will not relieve a party from the terms of a contract simply because he did not read it; he is bound to know its terms, and its contents, and his want of care will not avoid it. In re Mills, 111 B.R. at 196, supra (collecting Indiana cases). The law creates a presumption that a party to a written agreement or instrument knows the contents of the agreement he signs, and he cannot generally rely upon statements of others as to the character, content or legal effect

of an instrument. Id. (collecting Indiana cases). However, under Indiana law "mens rea" is not an essential element of conversion, and the fact that the tortfeasor may have acted in good faith is immaterial. Id. Thus, an act might constitute a mere technical conversion and liability under state law, without the same also being "willful and malicious, and thus not render such a debt nondischargeable under §523(a)(6), which is based on federal law with federal standards rather than state law. Id., 111 B.R. at 197-98. As observed by the Court in In re Posta, 866 F.2d 364 (10th Cir. 1989):

> Although we agree that conduct which violates the rights of a creditor is wrongful, we refuse to infer that it is, by its very nature, "malicious." Instead, the focus of the "malicious" inquiry is on the debtor's actual knowledge or the reasonable foreseeability that his conduct will result in injury to the creditor, "not on abstract and perhaps moralistic notions of the ` wrongfulness' of the debtor's act." In re Egan, 52 B.R. at 507 n. 4. Thus, the Postas' sale of the trailer was not "malicious" simply because it violated the terms of the security agreement.
>
> Under §523(a)(6), the debtor's malicious intent can be shown in two ways. In the rare instances in which there is direct evidence that the debtor's conduct was taken with the specific intent to harm the creditor, the malice requirement is easily established. See e.g., In re Boren, 47 B.R. 293 (Bankr. W.D. Ky. 1985); In re Major, 44 B.R. 636 (Bankr. W.D. Mo. 1984). More commonly, however, malicious intent must be demonstrated by evidence that the debtor had knowledge of the creditor's rights and that, with that knowledge, proceeded to take action in violation of those rights. In re Nelson, 67 B.R. at 497; In re Dever, 49 B.R. 329, 332 (Bankr. W.D. Ky. 1984). Such knowledge can be inferred from the debtor's experience in the business, his concealment of the sale, or by his admission that he has read and understood the security agreement. In re Cullen, 71 B.R. 274, 282 (Bankr. W.D. Wis. 1987); In re Gantt, 56 B.R. 852, 857 (Bankr. E.D. Va. 1985); United Bank of Southgate v. Nelson, 35 B.R. 766, 776 (N.D. Ill. 1983).
>
> We are not persuaded by CIT's argument that the bankruptcy court misconstrued the term "malicious" as to require actual malice, or a specific intent to harm the creditor. Rather, the court correctly looked to whether the Postas had willfully disregarded the rights of CIT in making the sale. The court noted that the Postas were relatively inexperienced in business matters, that

> they had difficulty in understanding business concepts, and that they had not read the security agreement. See e.g., In re Walker, 44 B.R. 1, 3 (Bankr. S.D. Ohio 1983); In re Scarbaci, 34 B.R. 344 (Bankr. S.D. Fla. 1983); In re Casselli, 4 B.R. 531, 535 (Bankr. C.D. Cal. 1980). The evidence shows that, at all time, the Postas intended to fulfill their loan obligations to CIT by applying the proceeds of Mr. Swartz' note to the loan. See e.g., In re Camp, 11 B.R. 85, 89 (Bankr. N.D. Ga. 1981); In re Harris, 8 B.R. 88, 93-94 (Bankr. M.D. Tenn. 1980). They did not conceal the sale from CIT and, in fact, requested CIT's assistance when it appeared their arrangement with Mr. Swartz had gone sour. Compare In re Fields, 44 B.R. 322, 330 (Bankr. S.D. Fla. 1984). We agree with the bankruptcy court that, in light of these facts, at most, all that occurred was a "technical conversion." Technical conversions do not fall within the §523(a)(6) exception to discharge. Davis v. Aetna Acceptance Co., 293 U.S. 328, 331-32, 55 S. Ct. 151, 152-53, 79 L. Ed. 393 (1934); In re McGinnis, 586 F.2d at 163.
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> * * * *
>
> In this case, however, the threshold question, as noted above, is whether the Postas had any knowledge that the sale would violate the terms of the security agreement. The district court found that the Postas had no knowledge of such terms of the security agreement. It properly concluded that, because they did not knowingly violate CIT's rights by selling the trailer, the Postas' conversion of CIT's property was not "malicious." That CIT did not acquiesce in the sale was therefore irrelevant.

Id., 886 F.2d at 367-68. And as correctly observed by the Court in In re Stanley, 66 F.3d 664 (4th Cir. 1995), a debtor's knowledge that his act would affect another's rights may be proved by circumstantial evidence; "implied malice… may be shown by the acts and conduct of the debtor in the context of [the] surrounding circumstances." Id. 66 F.3d at 668. (quoting St. Paul Fire & Marine Ins. Co. v. Vaughn, 779 F.2d 1003, 1010 (4th Cir. 1985)). Accord In re Stelluti, 94 F.3d 84, 88 (2nd Cir. 1996) (malice may be circumstructual or implied.) (Citing Stanley, and In re Walker, 48 F.3d 1161, 1164 (11th cir. 1995) with approval). Compare In re Grier, 124 B.R. 229, 233 (Bankr. W.D. Tex. 1991) (Simply because sale was in violation of security agreement and was in fact an

intentional sale on part of debtor, should not be enough to trigger a finding of malice. If this were the case, then any intentional conduct would fall within the §523(a)(6) exception to discharge, and the term "malicious" would be effectively read out of the statute); In re Nelson, 67 B.R. 491, 498 (Bankr. D. Minn. 1985) (a debtor's knowledge that a secured creditor's rights are being violated is insufficient to establish malice absent some additional aggravated circumstances. In cases involving conversion of secured collateral a heightened level of culpability must be found going beyond reckless and beyond an intentional violation of a security interest. A debtor's malice must be determined at least in part by the objective likelihood of harm to the secured creditor's interests created by the debtor's actions.) (citing, In re Long, 774 F.2d 875, 880 (8th Cir. 1985)).

The knowledge that the debtor had of the secured creditor's rights in the collateral can be inferred from the surrounding circumstances, such as the debtor's business experience, concealment of the sale, or by an admission that the debtor read and understood the security agreement, which forbid the sale, or the debtor admits he understood what was meant by the term security agreement and collateral used as security. Posta, 866 F.3d at 367-68, supra; In re Dorman, 98 B.R. 560, 568 (Bankr. D. Kan. 1987) (collecting cases); Matter of Ries, 22 B.R. 343, 347 (Bankr. W.D. Wis. 1982); In re Cardillo, 39 B.R. 548, 550-51 (Bankr. D. Mass. 1984). For instance, when the debtor is a relatively sophisticated businessman and knows the consequences of his conversion, courts are reluctant to hold the debt dischargeable, not because businessman are held to a higher standard, but because they are presumed to know the harm that will result from a conversion of a secured party's collateral. In re Eisner, 35 B.R. 86, 88 (Bankr. N.D. Ohio 1983).

As observed by Collier on Bankruptcy:

> Secured creditors whose collateral was disposed of by the debtor often assert nondischargeability claims under section 523(a)(6) on the theory that the security interest was willfully and maliciously converted. Transfers in breach of a security agreement may give rise to nondischargeable liability when the debtor's conduct is knowing and certain or almost certain to cause financial harm. Unless the creditor can prove not only that the debtor knew of the security interest, but also that the debtor knew that a transfer of the property was wrongful, the debt should not be found nondischargeable. Courts must be careful not to equate a breach of contract, which happens to be a security agreement, with conduct causing wilful and malicious injury.

Collier on Bankruptcy, Par. 523.12[3], pp. 523-94-95 (L. King, 15th ed. Rev.) (footnotes omitted). See e.g., In re Wincher, 210 B.R. 286, 288 (Bankr. E.D. Mich. 1997). (debtor's sale of creditor's collateral, without more, is insufficient to establish basis for denying discharge on willful and malicious injury grounds).

It is true at common law that a corporate officer, stockholder, director, agent or employee is not personally liable for the torts of a corporation or of any other agent merely because of his office or holdings, and that some additional connection with the tort is required. Bowling v. Holdeman, 413 N.E. 2d 1010, 1014 (Ind. App. 1980); Birt v. St. Mary Mercy Hospital of Gary, Inc., 175 Ind. App. 32, 38, 370 N.E. 2d 379, 382 (1977). However, a corporate office or shareholder cannot escape liability by claiming that he acted on behalf of a corporation because an agent is liable for his own torts. American Independent Management Systems, Inc. v. McDaniel, 443 N.E. 2d 98, 108 (Ind. App. 1982) (corporate officers cannot escape liability for fraud by claiming he acted on behalf of corporation were corporate officers personally participated in fraud); Howard Doge & Sons, Inc. v. Finn, 181 Ind. App. 209, 212-13, 391 N.E. 2d 638, 641-42 (1979), (officer personally liable for

conversion as well as corporation. An agent who commits a tortious act is equally liable with the principal and agent cannot escape liability on the grounds he acted for a principal). Thus, when a debtor who, as an officer of a corporation, actually participates in the willful and malicious conversion of property which is subject to the security interest of a third party, he is personally liable to said party and thus the debt is nondischargeable pursuant to §523(a)(6). See Ford Motor Credit Co. v. Owens, 807 F.2d 1556, 1559 (11th Cir. 1987). (Citing, In re Nicoll, 42 B.R. 87, 89 (Bankr. E. D. Ill. 1984); In re Schwartz, 36 B.R. 355, 359 (Bankr. E. D. N. Y. 1984) and Matter of Penning, 22 B.R. 616. 619 (Bankr. E. D. Mich. 1982)); Chrysler Credit Corp. v. Perry Chrysler Plymouth, 783 F.2d 480, 486 (5th Cir. 1986).

Count II of J & J's Complaint is based on Section 523(a)(6) which sounds in tort. J & J's allegations are for tortious, wilful and malicious, conversion by the Debtor of the Equipment of A-OK, and the proceeds thereof, in which J & J had a security interest, and thus the fact that the Debtor was officer or shareholder of A-OK and may not be personally obligated contractually on the Note and Security Agreement he executed on behalf of A-OK, does not affect the result of this nondischargeablity proceeding by J & J for actions taken by the Debtor in personally converting the proceeds of A-OK's Equipment subject to J & J's Security Agreement.

To prevail pursuant to §523(a)(6) J & J must prove by a preponderance of the evidence in the conjunctive that the acts of the Debtor relating to the sale of the Equipment, and the failure of the Debtor to pay over the proceeds thereof to J & J were both (1) "wilful" and (2) "malicious".

J & J has clearly satisfied the first prong of §523(a)(6) i.e. that the acts of the Debtor in converting J & J's collateral were wilful, rather than merely negligent, reckless, or accidental. J & J has shown by a preponderance of the evidence by the Debtor's own testimony in open Court that he clearly understood what the Security Agreement meant, i.e., that by virtue of the Security Agreement he executed on behalf A-OK that J & J held a security interest in the Equipment to secure the debt of A-OK to J & J, and that he understood the consequences of his acts by deliberately and intentionally selling said Equipment to various third parties with full knowledge of J & J's security interest therein, which injured J & J. That is, the Debtor's intentional conduct under the circumstances was clearly "wilful", as he knowingly proceeded to sell the Equipment without J & J's prior consent and with full knowledge that by so doing he had wilfully disregarded and violated J & J's rights under the Security Agreement which injured J & J.

The next issue to be decided is whether J & J has met its burden of showing that these intentional acts of the Debtor in converting the Equipment were "malicious". As indicated by the Seventh Circuit "[m]alicious means in conscious disregard of one's duties or without just cause or excuse; it does not require ill-will or specific intent to do harm." Matter of Thirtyacre, 36 F.3d at 700. Thus, J & J need not show that the Debtor had a subjective intent to harm J & J by converting the Equipment. As noted by the Court in In re Pasta, 886 F.2d at 367, under §523(a)(6) it is rare that there is direct evidence that debtor's conduct was taken with the specific intent to harm the creditor. This is the case in this Adversary Proceeding. However, malice of the Debtor may be constructive or implied by the surrounding circumstances. In re Stelluti, 94 F.3d at 881. Accordingly, the Court will

analyze all of the relevant and material facts surrounding the sale of the Equipment in question by the Debtor to determine if malice by the Debtor can be implied.

As noted above, the Debtor acknowledged that he signed the Security Agreement, which clearly had attached thereto as Schedule A a detailed, itemized list of the Equipment which he also admitted he signed, and that he admitted he understood that the Equipment was given as collateral for A-OK's debt to J & J. Thus, the Debtor had actual knowledge of J & J's security interest in the Equipment, and that it was reasonably foreseeable by the Debtor that his sale of the Equipment would result in an injury to J & J.

The Debtor was the sole officer and stockholder of A-OK, and thus had complete and unfettered possession and control over the use, location, and disposition of the Equipment. There is no competent evidence in the record that J & J either expressly or impliedly consented or otherwise acquiesced by a course of dealing to the sale of the Equipment subject to the Security Agreement prior to or subsequent to the sale thereof by the Debtor, or that J & J expressly or impliedly waived or released its valid security interest in the Equipment, or the proceeds thereof.

There was a total of ninety-five separate pieces of Equipment given by A-OK to J & J as collateral for the debt by A-OK. Only eighteen pieces of Equipment were repossessed by J & J leaving Seventy-seven separate pieces of Equipment that the Debtor cannot account for in any way. The Debtor states he has no personal memory whatsoever of who he sold the Equipment to, when it was sold, or the amount the various pieces of Equipment were sold for, and that he kept no books and records whatsoever as to these various sales. The Court finds that the testimony of the Debtor is not reliable or credible. The Debtor as the sole officer and

stockholder of A-OK, had complete control over the Equipment and yet he asserted under oath, he could not account for any one piece of the seventy-seven pieces of Equipment that were not returned to J & J.

In addition, the Security Agreement was executed on May 22, 1990, and A-OK was effectively out of business by December of 1991. Thus, the Debtor inexplicably disposed of seventy-seven of the ninety-five pieces of Equipment during this period of approximately eighteen months without the prior authorization of J & J, and yet during that time made only one payment of $2,200.28 to J & J on September 18, 1990.

There also is no evidence on the record that the Debtor ever asked J & J for its prior consent to sell the Equipment, or that he ever advised J & J that he had sold the Equipment after he had done so. This failure to obtain prior consent and the concealment of his unauthorized disposition of the Equipment is further evidence of implied malice by the Debtor.

The Debtor's unauthorized use of the proceeds of the sale of the Equipment is further circumstantial evidence of implied malice, as is the fact that the business of A-OK was failing when the sales were made. The Debtor acknowledged that he used some unspecified portion of the proceeds of the sale of the Equipment to pay his own personal expenses rather than to pay J & J or other corporate obligations of A-OK. The bank records of A-OK do not reflect any deposits of the proceeds of the various sales of the Equipment by the Debtor, by which the Debtor could show that the monies were not used by the Debtor personally, but to pay legitimate business debts of A-OK, and preserve its going-concern value.

The Debtor maintained no books and records whatsoever as to when the Equipment

was sold, to whom he sold the Equipment, or the price obtained therefore. The Debtor testified that all sales were in cash and no receipts were given. This is further circumstantial evidence that the Debtor maliciously intended to injure J & J by consciously concealing the various Equipment sales from J & J. The Debtor did not demonstrate any just cause or good faith reason for failing to remit the sale proceeds to J & J. There is no evidence in the record that the Debtor operated under an honest but mistaken belief engendered by a course of dealing or acquiesce by J & J that J & J had consented to the sale of the Equipment, or the use of the proceeds thereof by the Debtor.

Accordingly, the Court decides that the Debtor wilfully and maliciously converted the Equipment in question, as will as the proceeds thereof, and thus the debt of A-OK to J & J is nondischargeable in the Debtor's Chapter 7 case pursuant to §523(a)(6).

Next, the Court must address the amount of damages to be awarded to J & J. The Court will apply state law, or the law of Indiana, in determining damages to be awarded in a nondischargeability proceeding. See In re Johnson, 120 B.R. 461, 468 (Bankr. N. D. Ind. 1990).

E.

Damages

A judgment obtained by a creditor in a dischargeability proceeding arising out of the conversion of a creditor's collateral is limited to the market value of the collateral at the time it was converted. Matter of Vitreous Steel Products Co., 911 F.2d 1223, 1233 (7th Cir. 1990) (citing, THQ Venture v. SW, Inc., 444 N.E.2d 335, 340 (Ind. App. 1983)); STAR BANK, N. A. v. Laker, 637 N.E.2d 805, 807 (Ind. S. Ct. 1994); Plymouth Fertilizer Co.,

Inc. v. Balmer, 488 N.E.2d 1129, 1140 (Ind. App. 3rd Dist. 1986), rehg. den., trans. den.; Coffell v. Perry, 452 N.E.2d 1066, 1069 (Ind. App. 2nd Dist. 1983). See also, Matter of Burdick, 65 B.R. 105, 107 N. 1 (Bankr. N. D. Ind. 1986); In re Cline, 52 B.R. 301, 303-04, N. 6 (Bankr. W. D. Ky. 1985); In re Tanner, 17 B.R. 201, 203 (Bankr. W. D. Ky. 1982).

Damages do not include the full balance due and owing under the agreement or any attorney's fees contemplated by the agreement in that a §523(a)(6) dischargeablitiy proceeding is not based on contract, but rather a federal statute sounding in tort. Damages for conversion are bounded by the balance due the creditor rather than the value of the collateral at the time and place of sale. Accordingly, where the balance due on the underlying agreement is less that the value of the converted chattels, the creditor will be limited to the balance due. Matter of McCune, 82 B.R. 510, 515, N. 13 (Bankr. W. D. Mo. 1987). Thus, the amount of the debt to be held nondischargeable for a conversion in violation of §523(a)(6) is the lesser of the value of the converted property or the amount of the indebtedness. In re Gantt, 56 B.R. 852, 858 (Bankr. E. D. Va. 1985). See also In re Modicue, 926 F.2d 452, 453 (5th Cir. 1991); BonFiglio v. Harkema Associates, Inc., 171 B.R. 245, 251 (E. D. Mich. 1994), Aff'd 82 F.3d 417 (6th Cir. 1996).

It is clear that an award of damages cannot be based on mere speculation or conjecture. However, in general, no particular degree of mathematical certainty is required in the awarding of damages. Colonial Discount Corp. v. Berkhardt, 432 N.E. 2d 65, 67 (Ind. App. 1982). The amount of the damages awarded must be within the scope of the evidence. Id. Here, the Court concludes that J & J has met its burden by a preponderance

of the evidence and has shown through the unrefuted testimony of Harper, as Vice President and General Manger of J & J, having some twenty-six years experience in buying, selling, or otherwise dealing in amusement equipment that, more likely than not, the wholesale market value of the Equipment was approximately $159,830.00 when converted by the Debtor.

J & J did not have an opportunity to inspect and appraise the Equipment before it was converted by the Debtor by the sale thereof to unknown third parties without J & J's knowledge or prior consent. If a Defendant through artifice or concealment puts it out of the power of the Plaintiff to show the quality and value of the property that was converted, the Defendant may be held liable for the best quality of the property. Am. Jur.2d, Conversion, §105. See also In re Gantt, 56 B.R. at 858-59, supra ("when wrongful conduct has rendered difficult the precise damages suffered by the party affected, the best available evidence before the court is sufficient to fix the amount of damages." (quoting, In re Ricker, 26 B.R. 862, 8 64 (Bankr. E. D. Tenn. 1983)); Cline v. Roundtree, 236 F.2d 412, 413 (6th Cir. 1956) ([A] defendant whose wrongful conduct has rendered difficult the ascertainment of the precise damages suffered by the Plaintiff, is not entitled to complain that they cannot be measured with the sum exactness and precision as would otherwise be possible."). The unrefuted testimony of Harper was that the Equipment that was converted by the Debtor was approximately one year old at the time of conversion, and thus Harper, applying an industry standard of depreciation at the rate of twenty per cent per year for new equipment, reduced his estimate of the value of the Equipment at the time of conversion by twenty per cent to $159,830.00. This was the best evidence available to the Court in awarding damages, as the Debtor not only did not offer any evidence on the issue of damages,

he consistently testified he could not recall what Equipment was sold, when it was sold, to whom, and for what price.

J & J alleged in its Complaint that A-OK was indebted to it on the Note executed by the Debtor on behalf of A-OK in the principal sum of $201,573.72, plus interest at the rate of six percent per annum from August 7, 1991, together with reasonable attorneys' fees and costs. The estimated value of the Equipment at the time of conversion has been found by the Court to be $159,830.00, which is less than the principal balance due on the Note. As noted above, the amount of the debt to be held nondischargeable for conversion based on §523(a)(6) is the lesser of the value of the converted property or the amount of the indebtness. See In re Gantt, 56 B.R. at 858. Thus, the principal amount of the debt that shall be determined to be nondischargealbe shall be $159,830.00.

F.

Prepetition Interest

Ancillary obligations such as attorney's fees and interest may attach to the primary debt; consequently their status depends on that of the primary debt. Thus, when a debt is determined to be nondischargeable, the attendant attorney's fees, interest and costs are also nondischargeable. Klingman v. Levinson, 831 F.2d 1292, 1296-1297 (7th Cir. 1987) (citing, In re Hunter, 771 F.2d 1126, 1131 (8th Cir. 1985), and In re Foster, 38 B.R. 639, 642 (Bankr. M. D. Tenn. 1984)). See also Matter of Mayer, 51 F.3d 670, 677 (7th Cir. 1995); Matter of Church, 69 B.R. 425, 435-436 (Bankr. N. D. Tex. 1987).

J & J shall also be awarded prejudgment interest on the principal sum of $159,830.00. When a federal judgment is based on a state law claim, as here, the Court

must look to state law to determine the propriety of prejudgment interest on recovery. The Travelers Insurance Company v. Transport Insurance Company, 846 F.2d 1048, 1053 (7th Cir. 1988). However, federal law governs as to postjudgment interst on a federal judgment. Id. See 28 U.S.C. §1961(a).

Indiana courts have awarded prejudgment interest to a claimant as a element of damages. Indiana Code 24-4.6-1-102 governs the rate of prejudgment interest in Indiana in absence of an agreement and provides as follows:

> When the parties do not agree on the rate, interest on loans, or forbearances of money, goods, or things in action shall be at the rate of eight per cent (8%) per annum until payment of judgment.

See Ft. Wayne National Bank v. Scher, 419 N.E. 2d 1308, 1310-12 (Ind. App. 3rd Dist. 1981) (prejudgment interest must be awarded in conversion action, where the damages sought to be recovered are complete and ascertainable as of a particular time in accordance with fixed rules of evidence and known standards of value) (collecting cases). See also Nehi Beverage Co. v. Petri, 537 N.E.2d 78, 84 (Ind. App. 4th Dist. 1989).

Prejudgment interest is computed from the time the principal amount was demanded or due, and is allowable at the permissible statutory rate when no contractual provision specifies the rate. See Sand Creek Country Club v. CSO Architects, 582 N.E.2d 872, 876 (Ind. App. 3rd Dist. 1991). See also In re Johnson, 120 B.R. at 477, supra, (prejudgment interest accrues from the date of filing of plaintiff's complaint where plaintiff did not prove when he had made demand on the debtor prior to the filing of the complaint). There is no evidence in the record when J & J first made a demand on the Debtor. Thus, prejudgment interest shall be awarded from the date the nondischargeability complaint was filed by J & J,

at the rate of 8% per annum to the date of the entry of judgment.

F.

Attorney's Fees

As to attorney's fees, the "American Rule" denies attorney fees to a litigant in a federal court in the absence of a contract, applicable statute, or other exceptional circumstances. Alaska Pipeline Co. v. Wilderness Society, 421 U.S. 240, 95 S. Ct. 1612, 44 L. Ed.2d 141 (1975). Under the American Rule, attorney's fees would not be added to a nondischargeable debt as a matter of course; however, if the debtor agreed to pay Attorney's fees, the fees are part of a debt held to be nondischargeable. Matter of Mayer, 51 F.3d at 677, supra. Generally in Indiana, each party must pay his own counsel fees in the absence of a statute or agreement providing otherwise. Trotcky v. Van Sickle, 227 Ind. 441, 85 N.E. 2d 638 (1949); St. Joseph's College et. al v. Morrison, Inc., 158 Ind. App. 272, 302 N.E. 2d 865, 870 (1973); Parrish v. Terre Haute Sav. Bank., 438 N.E. 2d 1,3 (Ind. App. 4th Dist. 1982).

The initial paragraph of the Security Agreement provides that A-OK shall pay J & J the principal sum of $178,716.00, plus interest, with reasonable attorney's fees and all costs of collection. Paragraph IV of the Security Agreement provides that A-OK shall pay J & J's reasonable attorney's fees and legal expenses incurred by J & J in retaking, preparing for sale, selling and the like upon default by A-OK.

The prayer for relief as to Count II of J & J's Complaint based on §523(a)(6) prays for an unspecified amount of attorney's fees. No request for attorney's fees is plead by J & J in the body of Count II of its complaint. Federal Rule of Bankruptcy Procedure 7008 (b)

expressly states that a request for an award of attorney's fees shall be pleaded as a claim in the Complaint. A request for attorney's fees in the prayer to a Complaint only is inadequate. See In re DeMaio, 158 B.R. 895, 891-892 (Bankr. D. Conn. 1993); In re Kellar, 125 B.R. 716, 721 (Bankr. N. D. N. Y. 1989); In re Odom, 113 B.R. 623, 625 (Bankr. E. D. Al 1990); In re AM Interns, Inc. 46 B.R. 566, 578 (Bankr. M. D. Tenn. 1985). Because Count II of J & J's Complaint only request attorney's fees in the prayer thereto, an award of attorney's fees is hereby DENIED. It is therefore,

ORDERED, ADJUDGED, AND DECREED, That the Plaintiff takes nothing by Count I of its Complaint based on §523(a)(2)(A), and that the Defendant have judgment of no liability. And it is further,

ORDERED, ADJUDGED, AND DECREED, that the debt by the Defendant to the Plaintiff pursuant to Count II of its Complaint is nondischargeable in the principal sum of $159,830.00 pursuant to §523(a)(6), together with prejudgement interest at the rate of eight per cent per annum from the date the Plaintiff's Complaint was filed to the date of judgment, plus costs. Postjudgement interest shall accrue at the rate of 3.65 percent per annum pursuant to 28 U. S. C. §1961(a).

The Clerk shall enter these Judgements on a separate document pursuant to Fed. R. Bk. P. 9021.

Dated: July 22, 2005

JUDGE, U. S. BANKRUPTCY COURT

Distribution:
Debtor
Attorney David Woodward
Attorney Bruce Berkman